THE ECONOMIC DEVELOPMENT REPORT CARD FOR MONTGOMERY COUNTY, MD 2004

	1997	1998	1999	2000	2001	2002	2003	2004
EMPLOYMENT CONDITIONS								
Employment Growth	B-	A	A	A	B	B	B	B
The Labor Market	A-	A	A	A	B+	B+	B+	B+
The Work Force		B	B-	B	B	B	B	B-
THE ECONOMIC BASE								
Highly Skilled, Knowledge-Based Economy	A+	A+	A+	A+	A+	A+	A+	A+
Professional and Business Services	B	B+	B+	A	B	B+	B	B
Federal Contracting	B+	B+	B-	B	B-	A-	B+	A+
The Retail Sector	A	B+	B	A-	B	B	B+	B+
THE BUSINESS ENVIRONMENT								
Business Attraction and Retention	B+	B	A-	A	B-	B	B+	A
County Tax Structure	B+	B+	A-	A-	A-	B-	B-	B-
CONSTRUCTION ACTIVITY AND DEVELOPMENT CAPACITY								
Non-Residential Construction	D	D	C+	B+	A-	A-	B+	B
Residential Development	C-	B	B	B	B	A-	A-	A-
PUBLIC SERVICES AND PUBLIC SECTOR CAPACITY								
Income Tax Receipts	A	A	A	A	B	C	B	A
The Property Tax Base	C	C	C	B-	B	B+	B+	A
Public Expenditures vs. Revenue Capacity	B	A	A	A	C	C	C	C
Transportation Capital Expenditures		C-	D	D-	F	D	D	D

By

The Economic Development Report Card Committee
of the Economic Advisory Council of Montgomery County
in conjunction with
The Department of Economic Development

October, 2005

THE 2004 ECONOMIC DEVELOPMENT REPORT CARD FOR MONTGOMERY COUNTY, MD

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PRINCIPAL FINDINGS

1. Growth gradually accelerated in the County's economy in 2004, with total employment in the County increasing by approximately one percent. The County added 5,000 private sector jobs in 2004. The County is on a stable growth trajectory that is likely accelerating in 2005, though employment growth rates are likely to remain well below growth rates in the late 1990's.

2. This year's grades are somewhat higher than for 2003, reflecting improvements in the economy and the much stronger fiscal position of the County. 2004 was a year in which many firms enjoyed improving market opportunities and higher profitability, with strong growth in federal contracting, housing construction and renovation, legal services, and financial services.

3. Building on the success of its first two business incubators, the County is in the planning and design stage for three more incubators. The County's new conference center has enjoyed great success, with first year bookings and revenues far exceeding initial targets, yielding a $1 million operating profit in FY05.

4. The market for commercial space has improved, with vacancy rates having fallen from their first quarter of 2004 peak (9.6%), to 8.1% in mid-2005. Larger numbers of prospective tenants are shopping for space, but closing new leases is still difficult. Very few new buildings are being started, and more robust job growth is needed to initiate the next expansion in building.

5. Housing completions declined in 2004 to 4,200 units, below the annual average of 5,000 units for the three-year period 2002-2004. Housing demand remains high, with median housing prices increasing 23% in 2004, now 67% above 2001 levels.

6. The County's fiscal position has dramatically improved, reflecting large increases in assessments and the property tax base. The tradeoff between higher public spending versus property tax relief will continue to be intensively debated. Public expenditures are now increasing at more than a seven percent annual rate, with a portion (one percent) of the FY06 budget growth financed by transferring funds from the capital budget. Given growing infrastructure needs, diverting capital funds into the operating budget implies very short run budget priorities.

7. Transportation congestion remains the biggest threat to future economic development and the quality of life in the County. The recent approval of the State of the route for the InterCounty Connector brings this critical project closer to initiation, but the County's investment in highway capacity and services remains very inadequate.

EXECUTIVE SUMMARY

The creation of an Economic Development Report Card to measure economic development progress was recommended in the 1996 Business Conference to advance the objective of making Montgomery County the “Community of Choice” for business. This Committee, established by County Executive Douglas Duncan, is pleased to issue this eighth Report Card. The Committee has awarded slightly higher scores in 2004 than in 2003, with most categories as “B” grades, reflecting the moderate rate of growth in the County.

The nation, the Washington region, and Montgomery County are now enjoying sustained economic growth. The U.S. economy is on a stable growth path with low inflation rates, relatively stable long term interest rates, and employment growth sufficient to gradually lower unemployment rates. Sustained productivity gains, cautious hiring decisions, and low inflation rates and combined to hold down wage increases. In turn, modest wage gains and high productivity imply only modest gains in unit labor costs, a key factor in helping firms remain price-competitive in an increasingly competitive worldwide marketplace. The prospects for continued productivity gains and low inflation rates offer the prospects of another long period of economic expansion. The next phase of the expansion will likely include more rapid expansion in business investment, which has grown only moderately to date compared to past recoveries.

MONTGOMERY COUNTY ON STABLE GROWTH TRAJECTORY

	Montgomery County			*Washington Region*
Year	*Jobs**	*Change*	*% Change*	*% Change*
1996	380,500	4,100	1.0%	2.2%
1997	391,400	10,900	2.9%	2.7%
1998	405,300	13,900	3.5%	2.9%
1999	417,400	12,100	3.0%	3.6%
2000	438,800	21,400	5.1%	4.8%
2001	440,700	1,900	0.4%	1.7%
2002	442,800	2,100	0.5%	0.3%
2003	444,600	1,800	0.4%	2.5%
2004	448,800	4,200	0.9%	2.7%
Quarterly				
2004.1	441,500	3,400	0.8%	2.9%
2004.2	450,900	4,000	0.9%	2.8%
2004.3	446,700	1,600	0.4%	2.2%
2004.4	456,000	7,900	1.8%	2.9%

*Note: *Payroll data for Montgomery County for years prior to 2004 adjusted downward previously reported data, to reflect recoding of private and local public sector employment in these years to other jurisdictions.*

Source: Maryland Department of Labor, Licensing and Regulation

The Washington region experienced a very shallow recession and has enjoyed the most rapid growth of any major metropolitan area in the nation over the last three years, aided by increases in the federal budget and federal contracting. The region has benefited from the extraordinary success of firms in the region in increasing their share of the market for federal contracting, now accounting for one sixth of all federal contracting.

Montgomery County’s economy has followed a somewhat similar path, with a very shallow recession, and is now on a sustained growth path, albeit at a lower growth rate than the Washington region and many of the County's surrounding jurisdictions. Employment increased about one percent in the County in 2004, with the unemployment rate remaining among the lowest in the State. Total employment increased by 4,200 jobs in 2004 (0.9%), with the private sector adding 5,000 new jobs (1.4% growth).

Employment

Employment growth in the County will likely be approximately 1.5% in 2005. Employment by employment agencies providing temporary and contract employees increased in the second half of 2004, a leading indicator of future job growth, and it is likely that the County is now experiencing faster job growth in mid-2005. The State of Maryland reports jobs growing at a two percent rate statewide in mid 2005, somewhat above the rate of growth of jobs nationally.

The County enjoys the strongest and most stable economic base in the State and a very highly educated work force, and accounts for 18% of all jobs in the State. Its employment base includes the largest concentration of federal employees in the State (40,700 employees, 32% of the State's total) and 96,400 jobs in professional and business services (26% of the State's total). Federal government contracting activity provided stability through the recession, and is now an important driver in the expansion.

Future hiring decisions of firms in the County will reflect nationwide trends in business hiring decisions, with employers cautious in hiring new workers, The sharp upward shift in productivity since the late-1990's has translated into less demand for workers. Businesses are very cost conscious, mindful of rapid increases in health care and other indirect labor costs, and facing more competitive markets domestically and world-wide. Business profits continue to increase at double-digit rates, with the share of business revenues going to profits increasing while the share to employee compensation is declining.

Job growth in the Washington region that began in the region in 2003 has accelerated in 2004. To date, the County has enjoyed less job growth during the recovery than the Washington region as a whole and many surrounding local jurisdictions. Employment in Frederick County increased at about a four percent rate in the last three years as employment and housing continues to expand northward in the I-270-Corrider. Montgomery and Frederick Counties and Northern Virginia are increasingly linked as workers commute between counties to job sites, and Anne Arundel County is now growing rapidly as a result of federal employment and contracting.

Future job growth in the County will depend on many factors, including the rate of expansion of the housing stock, construction of additional commercial space, and transportation costs to County work sites. As surplus labor is absorbed in surrounding jurisdictions, the County's job growth rate should converge toward growth rates in other jurisdictions, but will likely remain well below growth rates of the mid- to late-1990's.

Earnings growth in the County continues at a moderate pace, with average earnings per worker increasing 3.1-3.2% % in 2002 and 2003, and 3.4% in 2004. This reflects national trends – a low rate of inflation, slack in the labor market, and the fact that many firms no longer need to bid up wages to attract or retain workers.

Public sector employment declined by 800 jobs in the County, with federal employment declining by 500 jobs. Average earnings of federal employees increased 7.9% in 2004, to $80,500, exceeding average wage levels of employees in the two other largest and most highly compensated industry groupings within the private sector (Finance and Insurance, and Professional and Technical Services). Federal employment is a vital part of the core of the County's economy.

Interpreting private sector employment patterns is complicated by a lack of comparability in employment data by sub-sector from one year to the next due to "non-economic " changes in reporting – firms with multiple work sites reporting their employment in a different location from one year to the next, or reporting their activity under a different industry sub-code.

The County enjoyed job gains in construction, banking and credit intermediation, the financial securities sector, real estate, professional and business services, and health care. Employment in legal services has increased by about 25% since 2000, with two thirds of this increase in the last two years. Within the professional and technical services sector, employment in research and development firms continues to increase, a sector principally dependent on federal contracts. Manufacturing employment continues to decline in the County.

Federal contracting awards to County firms increased 34% in FY2004, and federal contracts are now almost 75% higher than in FY2001. Federal contracting has grown dramatically since 9-11, with expenditures focused on data processing, telecom, and professional services meeting defense and homeland security needs. County firms have been very successful in this market, increasing their share of procurement in the Washington area since 2001, after a period from FY1998 to FY2001 when contracting activity in the County was relatively flat.

Education

The County has a superb educational system at all levels, and continues to experience growing diversity of students in the Montgomery County Public Schools. Enrollment of Hispanic students is rapidly increasing, now comprising 19.4% of all students. The County is educating many students with special needs, including: in special education programs (11.9%), English as a Second Language (8.9%), low-income families (23.7%).

The County's efforts to improve the quality of education are proving very successful. A program begun in 1999 targets elementary schools that have the most challenging socioeconomic composition with all day kindergarten, smaller classes, and more specialized reading and math training, and has provided dramatic improvement in student learning as evidenced by large increases in Statewide tests of second grade students. High school students are taking SAT tests in record numbers, with increasing scores. The largest increases in the number of tests being taken is by African American and Hispanic students. A focus on middle schools is the next important target for special efforts and greater resources, an initiative now underway. Montgomery College and the Institutes at Shady Grove continue to provide high quality programs serving large numbers of post-secondary students, and are making important contributions to building the County's work force.

Economic Development

The County continues to pursue an active agenda in recruiting and retaining businesses. In 2004, the County Council approved a Strategic Plan for Economic Development for Montgomery County, which provides a comprehensive vision and plan to guide economic development strategy and actions for the future. The County is developing three new business incubators, and promoting private sector development in Rockville, Silver Spring and Wheaton. Silver Spring is now attracting employers and retail activity. The County's new conference center has been very successful in its first year of operation, with bookings and revenues far exceeding forecasts and earning a profit of $1 million that was credited to the County's FY05 budget.

The market for commercial space has significantly improved over the last 18 months, with vacancy rates now declining. Vacancy rates for Class A space have declined from a peak in the first quarter of 2004 of

10.9% to 7.7% in the second quarter of 2005. A larger number of prospective tenants are shopping for space, although tenants are still in a position to bargain hard and closing lease deals is difficult and often involves lengthy negotiation.

Commercial completions were well below trendline in 2003 and 2004, reflecting a slowing of construction commitments that occurred during the post-2001 economic slowdown. Very few projects are being started at present, implying completions will remain low for 2005 and 2006. While job growth has been sufficient to absorb some vacant space, a resumption of building will require a sustained acceleration of job growth above current levels.

The market for buildable land is likely to be increasingly important to the future path of commercial development. The supply of buildable commercial space in the County is limited. Even in a period with very few building commitments being made, there is virtually no buildable land available for purchase at a price that would make building profitable. When space demands increase, land prices for buildable commercial space will likely increase significantly, in turn affecting the rate of development and the price of office space. The pace of expansion of the office market will be critical to future long term job growth in the County.

Housing

The expansion in residential housing in the County that began in 1999 slowed to 4,200 units in 2004, somewhat below the annual average of 5,000 units completed in the 2002-2004 period. The pace of zoning approvals remains at a high level, with sites accommodating 7,400 units approved in 2004, with an annual average of 6,000 units over the four year period 2001-2004. Seventy percent of sites approved for new housing are for multi-family housing.

The pace of housing expansion is very important to the future job growth in the County, and to housing availability and the rate of housing price inflation. Demand for housing in the County continues to increase, reflecting low mortgage rates and the desirability of living in the County. Single family housing prices increasing 23.2% in 2004, the third year of very large increases (a 67% increase over the prior three years, 2001-2004). Price inflation increases the wealth of owners of land and property, but worsens the 'housing affordability' problem.

Recently initiated reviews of County zoning and permitting procedures, compliance, and project inspections -- including moratoriums on selected building activities -- as a result of concerns about projects in Clarksburg present major new uncertainties to residents, businesses, and developers. A timely completion of these reviews and the formulation of clear and transparent procedures that are administered with minimal delay and uncertainty is critical to continued expansion of the housing stock in the County. Predictability in zoning and permitting decisions is important to continued growth in residential construction.

County Fiscal Position

The County's fiscal situation has dramatically improved, reflecting previous increases in income and energy taxes and very rapid increases in assessments that have resulted in sharply rising property tax revenues. The County has underestimated revenues from income, recordation, and transfer taxes in recent years, providing additional budget flexibility as realized revenues are much higher than budgeted. The State budget has also improved dramatically, allowing the State to increase transfers to local governments in FY06.

The County has increased spending at a rapid rate from FY03 to the present, with expenditures rising by 7.7% in FY05 and budgeted to increase by 7.7% in FY06. The County maintained spending throughout the economic slowdown, financed by increases in taxes and fees. The structure of the County's budget is evolving. In the period FY98 to FY02, spending increased at a 6.3% annual rate, with the number of county employees increased approximately two percent per year; for the period FY02 through FY06, spending is increasing at a 7.1% rate and County Government employment (work years) has fallen by three percent over this four year period.

The County can expect increases in the property tax base exceeding ten percent annually for the next several years. Budgeting decisions each year for the immediate future will involve the choice between property tax relief versus higher spending. The FY06 budget stayed within the Charter limit on property tax revenues by enacting a four percent reduction in the tax rate and expanding targeted property tax relief for families with low incomes and net worth. However, the combination of major property tax reductions and spending increases of 7.7% were achieved only by borrowing approximately $32 million from the capital budget.

It is likely that the County will realize higher tax revenues in FY05 and FY06 than are projected, providing added budget flexibility (including the means to pay back the loan from the capital budget). Given the rapid growth in tax revenues and the growing infrastructure needs of the County, particularly in transportation, there are strong arguments for shifting more of the County's resources from growth of operating budgets into capital budgets.

Investing in transportation infrastructure remains a very pressing need, for increasing congestion is the biggest challenge to future economic development and the most important factor reducing the quality of life in the County. The County is making progress with its *Go Montgomery!* Initiative, a comprehensive plan to invest in transportation and improve services adopted by the County in 2003. Approval of the InterCounty Connector by the County Council and the selection of a route by the State are very important steps toward initiation of this vital project. The County continues to make significant investments in transit, but its investment in highways is inadequate. There has been little growth in the highway portion of the County's budget for many years, and administrative issues have resulted in actual spending lagging behind the level of appropriations.

EMPLOYMENT CONDITIONS

Employment Growth B

The County economy grew at a faster rate in 2004, with jobs increasing at a 0.9% rates (4,200 jobs). The private sector gained 5,000 jobs (+1.4%). Federal employment declined by 500 jobs.

Total Employment in the County, State, Washington Region and Northern Virginia
(Jobs in 000's)

	County Jobs			% Change Other		
Year	*Total*	*Change*	*% Change*	*State*	*Wash. Region*	*Northern VA*
1996	380,500	4,100	1.0%	1.3%	2.2%	3.7%
1997	391,400	10,900	2.9%	2.5%	2.7%	3.3%
1998	405,300	13,900	3.5%	2.5%	2.9%	4.2%
1999	417,400	12,100	3.0%	2.9%	3.6%	5.5%
2000	438,800	21,400	5.1%	2.7%	4.8%	6.4%
2001	440,700	1,900	0.4%	0.6%	1.7%	1.5%
2002	442,800	2,100	0.5%	0.4%	0.3%	-0.7%
2003	444,600	1,800	0.4%	0.4%	2.5%	1.1%
2004	448,800	4,200	0.9%	1.1%	2.7%	4.6%

Source: Maryland Department of Labor, Licensing and Regulation

It is likely that the County is now experiencing somewhat faster job growth in mid-2005. Growth in employment by employment agencies providing temporary and contract employees increased in the second half of 2004, a leading indicator of future job growth. The State of Maryland is reporting two percent job growth for the first half of 2005, indicating that the State's economy shows no signs of slower growth.

Total Employment Growth

Jurisdiction	*2003*	*2004*
Montgomery County	0.4%	0.9%
Washington Region	2.5%	2.7%
Northern Virginia	1.1%	4.6%
Prince George's County	0.3%	0.5%
Frederick County	4.6%	3.8%
Anne Arundel County	2.0%	4.3%
Howard County	1.1%	2.1%
Charles County	2.3%	3.2%

Source: Maryland Department of Labor, Licensing and Regulation

The County's employment growth rate is significantly lower than in the last recovery and during the boom of the late 1990's. Two factors account for the differences. First, the experience nationwide demonstrates that employment gains in this recovery are likely to continue to be slower than in the typical recovery path of previous recessions, given high rates of productivity and business firms' focus on bottom line profitability.

Secondly, the County is likely attracting a smaller share of its at-place employment at county worksites) from surrounding jurisdictions than in the 1990's. Several factors are likely contributing to this change. The expansion in the Maryland economy is broad-based and occurring statewide, and jurisdictions with unemployed workers and/or faster population and labor force growth are able to sustain higher job growth. Unemployment rates are higher in many parts of the State, and employers in other counties are rehiring unemployed workers. The economies in Frederick and Anne Arundel are much stronger than a year ago. Frederick is expanding rapidly as employment shifts up the 270-Corridor. Prince George's County continues to badly lag the region in recent years.

Job growth in the County is limited by housing availability and the cost of commuting into the County. Notwithstanding above average growth rates in housing completions, there is excess demand for housing and very little vacant housing.

<u>Goal</u>: Achieve employment growth of 2.0%, the target in the County's Strategic Plan for Economic Development.

The Labor Market B+

The County's unemployment rate remains among the lowest in the State, 3.1% in 2004, and 3.1% in the most recent month, May, 2005. Howard and Frederick Counties report unemployment rates of 3.0%. The expansion nationally and in the State is gradually absorbing underemployed labor resources. Montgomery County has little surplus labor to absorb. Interpretation of current unemployment data must await the State's revisions of unemployment rates for the period 2002 to the present. The methods the U.S. Labor Department and states use for calculating unemployment rates changed in 2005, with a greater reliance on the Current Population Survey and more rapid benchmarking of survey results. 2005 reported data are based on the new methodology. Completion of data revisions for the 2002-2004 time period will provide consistent data over the period since 2002 that will show how much labor has been absorbed since the recession.

Rate of Unemployment

Year	*County*	*State*
1997	2.6%	5.1%
1998	2.3%	4.6%
1999	1.8%	3.5%
2000	1.9%	3.8%
2001	2.3%	4.0%
2002	2.8%	4.4%
2003	2.6%	4.5%
2004	3.1%	4.2%
Jan. 2005	3.4%	4.6%
Feb. 2005	3.4%	4.6%
Mar. 2005	3.3%	4.4%
Apr. 2005	3%	4.1%
May. 2005	3.1%	4.1%

Source: Maryland Department of Labor, Licensing and Regulation

Goal: Maintain an unemployment rate at or below the lowest level of all counties in the State.

The County Work Force and Work Force Availability B-

The ability to attract a high quality work force to meets the employment needs of both private and public sector employers is critical to successful economic development. Today's knowledge based economy relies on a highly educated and skilled work force, with the ability to successfully learn new skills and to adapt to meet new challenges and work requirements. The long term need for workers spans a wide economic spectrum, including the most educated and skilled professional and managerial workers, a broad range of technicians, and a wide range of skills among service sector workers in health care, social and educational services, and retail-oriented occupations. For a very wide range of jobs throughout all occupations and skill levels, important basic worker attributes play an important role – reliability and dependability, being at work each day ready and willing to work hard, the ability to follow directions, and the ability to work with teams, co-workers, managers, and often customers.

The County is part of a metropolitan wide work force and draws its workers from both County residents and from persons living in surrounding jurisdictions that commute into the County to work. In 2000, 154,000 workers commuted into the County to work, from residences outside the County. A larger number of residents commuted to jobs outside the County. The County continues to enjoy the benefits of a highly educated and skilled residential work force. According to the 2000 Census, 27% of all residents 25 and over hold advanced degrees, and another 27% are college graduates, placing the County among the most educated in the nation. The County's education system is superb at all levels, and the County's long term commitment to supporting high quality education is one of principal determinants of the quality of the County's work force over the long run.

Two major challenges must be faced if the County is to be successful over the long run in recruiting the necessary work force: the high cost of housing and the shortage of housing that deters many workers or potential workers from living in the County, and the costs of commuting into the County from surrounding jurisdictions.

The very high price of housing in the County makes it increasingly difficult for many employees to live in the County. The staggering increases in housing prices are pricing housing beyond the reach of many county workers. Declining mortgage rates, which have remained lower than many forecasters have suggested, have helped residents invest in housing. However, housing prices are likely headed higher for the foreseeable future, reflecting the quality of life in the County, economic opportunities, and the shortage of housing. Housing price increases have been so large that many workers can not afford housing. The County is presently building housing at a rate that is below what is required to support job growth of two percent annually on a long term basis.

Rising transportation congestion makes commuting into the County very costly as well. East-West commuting is very difficult. In addition to investing in more transportation within the County, the County must play an active role in promoting regional solutions that provide critical interregional infrastructure that is needed to serve a large, mobile regional work force.

The challenges that the County faces in attracting a work force are long term in nature, little affected by an economic slowdown that followed September 11, 2001. The County's unemployment rate temporarily increased during the economic slowdown, but the increase was very modest and short-lived. Employers still report that it is difficult to attract and retain workers, traceable to the high cost of moving into the County to live or commuting into the County from surrounding jurisdictions. The solutions lie in promoting long term policies: expanding the housing stock, improving accessibility, and investing in the education of all residents, particularly those nearing entry to the work force or who are already in the work force.

<u>Goal</u>: Expand and train County's resident work force through educational and training programs coordinated with industry needs. Expand the housing stock and increase the rate of investment in transportation infrastructure, including regional approaches to transportation and employment accessibility.

Education and the Work Force

The County has a superb educational system at all levels. The County has enjoyed continuing successes in education at every level, with major contributions being made by educational institutions in educating the County's future (and present day) work force. Success in education is vital to the long term success of the County, for today's young people are the County's future work force.

Public School Enrollment - Increasing Diversity

School Year	*Total*	*White*	*Asian*	*Hispanic*	*African American*
1993-94	113,429	65,749	14,014	12,260	21,009
1998-99	127,852	66,409	16,380	17,815	26,820
2003-04	139,203	62,072	19,908	26,058	30,736
2004-05	139,339	60,300	20,100	27,000	31,500
% Change 6 Years	9.0%	-9.2%	22.7%	51.6%	17.4%
% Change 1 Year	0.1%	-2.9%	1.0%	3.6%	2.5%
Student Composition 2004-2005	100.0%	43.3%	14.4%	19.4%	22.6%

Students with Special Needs in Academic Year 2004-05

English as a Second Language 8.9%

Free and Reduced Price Meal Services 23.7%

Special Education 11.9%

Source: Montgomery County Public Schools

Montgomery County Public Schools (MCPS) continue to experience a dramatic transformation in the demographic composition of students, with an increasingly diverse student body with much higher fractions of African American and Hispanic students and larger numbers of students with English as a second language. The County is also educating many students with special needs: in special education programs (11.9%), with English as a Second Language (8.9%), and in families with lower incomes (23.7%). The Hispanic student population has increased 52% in the most recent five years, and now comprises 19.4% of the student body. The County's graduating high school class in June, 2005 will likely be the last high school class with a majority Caucasian student body.

The County's efforts to improve the quality of education are proving very successful. The County has been administering standardized Grade 2 tests being used nationwide since 2001. County students score very high, and the gap between County and Nationwide test results has widened in the 2001-2005 time period. Ninety-three percent of MCPS schools scores at or above the 75th percentile nationwide in mathematics. The most dramatic gains in test results are among African American, Hispanic, students receiving subsidized meals based on family income, and students whose native language is not English. A County program begun in 1999 has targeted elementary schools with the most challenging socioeconomic composition and offers all day kindergarten, smaller classes, and more specialized reading and math training, resulting in dramatic improvements in student learning, as evidenced by large increases in scores. All of the fourteen underperforming schools that have been the focus of special attention performed above the national median in every testing area in 2005 for the first time. SAT test scores in the County remain at very high levels, the highest in the State. Increasing achievement scores for all race and ethnic groups is an especially important continuing challenge. Students are being encouraged to take SAT tests. In 2004 84% of tenth

AP Tests Taken: Montgomery County

	Graduating Class 2000		*Graduating Class 2004*	
	Took AP Test	*Earned 3 or Higher*	*Took AP Test*	*Earned 3 or Higher*
All MCPS	34.4%	28.9%	48.6%	39.4%
African-American	11.1%	8.1%	23.3%	14.6%
Asian American	47.8%	38.7%	66.9%	52.7%
Hispanic	16.9%	15.5%	29.5%	23.4%
White	43.3%	37.0%	58.5%	49.8%

Source: Montgomery County Public Schools

Montgomery County SAT Scores by Ethnic Group

Year	*% Tested*	*Total*	*White*	*Asian*	*Hispanic*	*African American*
1994-1995	73%	1,087	1,137	1,124	996	940
1995-1996	75%	1,088	1,137	1,133	1,002	919
1996-1997	76%	1,092	1,138	1,111	993	922
1997-1998	77%	1,092	1,137	1,133	994	919
1998-1999	79%	1,096	1,149	1,131	973	921
1999-2000	80%	1,093	1,152	1,123	962	914
2000-2001	79%	1,092	1,154	1,127	949	911
2001-2002	81%	1,095	1,159	1,138	950	906
2002-2003	81%	1,094	1,153	1,127	945	917
2003-2004	80%	1,102	1,163	1,160	944	917

Source: Montgomery County Public Schools graders took the PSAT test versus 30% five years earlier. SAT test results remain relatively stable, with declines in SAT scores in some ethnic groups principally because more students are taking tests.

The school system is increasing the number and range of challenging courses, and dramatically increasing the number of students taking Advanced Placement (AP) courses. Students achieving a satisfactory score on nationwide AP tests receive college credits.

Montgomery College Enrollments

Year	*Total Enrollment*	*Full-Time Equivalent Enrollment*	*% Change One Year Ago*
Fall, 1999	20,843	12,602	3.2%
Fall, 2000	20,923	12,915	2.5%
Fall, 2001	21,349	13,510	4.6%
Fall, 2002	21,805	13,840	2.4%
Fall, 2003	21,671	13,900	0.4%
Fall 2004	22,254	14,240	2.7%
Fall 2005	22,800	n/a	2.5%

Source: Montgomery College

In 2004, County high school students took 9,040 AP tests, an increase of 165% from five years earlier. Nearly one fourth of all seniors took at least one AP test in 2004. Eight percent of African-American students took an AP test in 2004, more than double the percentage four years earlier. The number of students earning at least one grade of 3 (accepted for college credit at many institutions) has risen fifty percent from four years earlier. The number of students who are AP Scholars (a designation for students with at least three courses with a score of 3 or better) has doubled in the last four years, to include 2,036 students in the graduating class of 2004 (approximately twenty percent of the graduating class).

Post secondary education institutions continue to expand activities that educate and improve the County's work force. The efforts of Montgomery College and the Universities at Shady Grove are making valuable contributions to building the County's future work force. Montgomery College continues to expand its curriculum and the number of students it serves, with a wide range of full time and part time programs and expanding operations at all of its campuses. Montgomery College enrolled 22,254 students in Fall, 2004 (2.7% above Fall, 2003).

The program at the Universities at Shady Grove, which is a cooperative effort of many of the four year institutions in the State, enrolls 2,100 students, including 680 students in full time undergraduate daytime programs. Undergraduate degree programs in nursing and business are well established, and a new program in criminology is now expanding. The program at Shady Grove is near capacity with its current two buildings, and further growth will await completion of its third building, expected to be completed in Fall, 2008. Planning for this expansion is underway, with articulation agreements being worked out with community colleges and with University System of Maryland partner institutions.

Universities at Shady Grove Enrollment (Fall 2004)

Undergraduate Daytime Programs

Institute providing program:	*Enrollment*
Towson University, Elementary and Special Education	34
University of Baltimore, Psychology	33
University of Maryland, Baltimore Nursing	116
UMBC, Social Work	49
UMBC, Information Systems	53
UMCP, Business	244
UMCP, Biological Sciences	37
UMCP Criminology and Criminal Justice	8
UMD, Eastern Shore, Hotel and Restaurant Management	39
UMD, University College; Computer and Info Science	157
Total	770

Source: Universities at Shady Grove

Universities at Shady Grove			
	Undergraduate Daytime Programs	*Weekend & Evening Undergraduate and Graduate Programs*	*Total*
Fall, 2000	223	2,044	2,062
Fall, 2001	453	2,430	2,445
Fall, 2002	727	2,360	2,380
Fall, 2003	770	1,486	2,256
Fall, 2004	680	1,449	2,129

Source: Universities at Shady Grove

<u>Goal in Education</u>: Improve the performance of all students, closing the gap in achievement by ethnic group and school, and expand the range of programs and number of students enrolled at Montgomery College and at the Universities at Shady Grove.

THE ECONOMIC BASE

Highly Skilled, Knowledge-Based Economy A+

The County has the premier employment base of the State, a stable core of growth-inducing sectors that effectively compete in national and international markets. The success of these sectors generates demand for products and services from other sectors in the County as well as producing employment earnings for County residents. The County has the highest concentration of employment in the state professional and business services, high technology manufacturing, and biotechnology and related research activities in the State, and accounts for 26% of employment in the professional and business services sector in the State. Average annual earnings in these leading export-oriented sectors approximates $70,000. The success of the knowledge-based employment core reflects the high education and skill levels of County employees. Average earnings of all employees in the County was $50,549 in 2004. Reported

Change in Federal Government, Manufacturing, Professional and Business Service Jobs Montgomery County

	Federal Government		*Manufacturing*		*Prof. & Business Services*	
Year	*Jobs*	*% Change*	*Jobs*	*% Change*	*Jobs*	*% Change*
1993	45,438	-0.8%	15,423	1.6%	67,067	0.8%
1994	43,781	-3.6%	16,414	6.4%	66,453	-0.9%
1995	42,595	-2.7%	16,229	-1.1%	68,256	2.7%
1996	41,427	-2.7%	14,471	-10.8%	73,107	7.1%
1997	39,191	-5.4%	15,626	8.0%	77,149	5.5%
1998	38,817	-1.0%	15,594	-0.2%	83,121	7.7%
1999	39,006	0.6%	15,848	1.6%	88,116	6%
2000	39,616	1.4%	17,242	8.8%	95,802	8.7%
2001	40,397	2.0%	18,809	*	96,029	*
2002	41,179	1.9%	17,392	-7.5%	95,640	-0.4%
2003	41,189	0.0%	16,222	-6.7%	95,898	0.3%
2004	40,656	-1.3%	15,454	-4.7%	96,426	0.6%

Source: Maryland Department Labor, Licensing and Regulation

** 2000 vs. 2001 data not comparable due to changes in sub-industry coding*

Average Annual Montgomery County Earnings 1993-2004

Year	*Average Earnings Per Worker*	*% Change County*	*% Change State*
1993	$32,921	3.2%	2.0%
1994	$33,759	2.5%	2.6%
1995	$34,693	2.8%	2.6%
1996	$35,991	3.7%	3.9%
1997	$37,667	4.7%	4.9%
1998	$39,657	5.3%	4.9%
1999	$41,301	4.1%	3.6%
2000	$43,671	5.7%	5.5%
2001	$45,821	4.9%	5.0%
2002	$47,260	3.1%	3.0%
2003	$48,792	3.2%	3.2%
2004	$50,549	3.4%	4.5%

Source: Maryland Department Labor, Licensing and Regulation average earnings includes both full and part time workers (i.e. all employees of a firm working any portion of a year appear in the data), hence reported average earnings of full time workers is considerably higher than the reported average for all employees.

Average Annual Earnings, Montgomery County, Selected Sectors, 2004

	Earnings ($)	*% Change from One Year Ago*
Total	50,549	3.4%
Total Private Sector	47,814	2.8%
Federal Government	80,540	7.9%
Selected Private Sub-sectors:		
Construction	50,618	5.9%
Manufacturing	76,077	5.0%
Finance and Insurance	80,053	8.9%
Information	75,971	10.6%
Professional and Technical Services	72,109	6.5%

Source: Maryland Department of Labor, Licensing and Regulation

Federal employment remains an important part of the County's economy. The federal government employs 40,600 persons in the County, with a predominance of professional and scientific employees in the National Institute of Health (NIH), Federal Drug Administration (FDA), National Oceanic and Atmospheric Administration (NOAA) and other science-based organizations. Average earnings of federal employees was $80,500 in 2004, an increase of 7.9% from 2003. The level of federal employee earnings reflects the disproportionately large fraction of highly educated and skilled professionals across a wide range of agencies and occupations in the County's federal work force. Federal earnings are now consistently increasing more rapidly than private sector employee earnings in the County.

The Employment Composition of Montgomery County, 2004

Sector	*Employment*	*Montgomery County as % of State Total*	*State*
Total	448,778	18.2%	2,460,292
Total Private Sector	370,958	18.4%	2,013,983
Selected Private Sub-sectors:			
Construction	29,116	16.6%	175,902
Manufacturing	15,454	10.8%	143,108
Transportation Trade & Utilities	64,351	13.8%	464,669
Information	14,831	29.6%	50,121
Financial Activities	34,591	22.1%	156,188
Professional and Business Services	96,426	26.0%	370,605
Education and Health Services	55,193	16.6%	333,375
Leisure and Hospitality	38,329	17.1%	224,325
Other Services	21,308	24.1%	88,493
Total Government	77,820	17.4%	446,308
Federal Government	40,656	32.0%	126,911
State Government	1,061	1.1%	95,921
Local Government	36,103	16.2%	223,476

Source: Maryland Department of Labor, Licensing and Regulation

Reflecting national trends, earnings growth per employee has slowed significantly, to 3.4% in 2004, far below the growth rates in the pre-recession period. Higher unemployment rates, low inflation rates, and caution by firms in making hiring commitments have all contributed to the lessening in wage gains, especially among non-supervisory workers. National data show that earnings patterns continue to diverge by education and skill level, with earnings growing at a much lower rate for lesser skilled and less educated workers, and at much faster rates for the more highly skilled portion of the work force.

Goal: promote further growth in highly skilled, professional job sectors.

Growth in the County's professional and business services sector was relative constant through the recession, providing stability in the County economy, and is now increasing. Professional services firms are engaged in information technology, telecommunications, research and development, engineering and architectural services, and management consulting and accounting services. The professional services sector includes many firms engaged in federal contracting.

Employment in Computer System Design & Related Sectors

	County		*Washington Region*	
Year	*Jobs (000)*	*% Change*	*Jobs (000)*	*% Change*
1996	12.6	3.1%	74.3	5.3%
1997	13.6	7.9%	83.2	12.0%
1998	15.3	12.5%	94.0	13.0%
1999	17.6	15.0%	108.6	15.5%
2000	19.6	11.4%	120.6	11.0%
2001	19.1	-2.6%	121.7	0.9%
2002	18.9	-0.8%	120.0	-1.4%
2003	18.7	-1.4%	124.1	3.4%
2004	16.9	-9.5%	128.7	3.7%

Source: Maryland Department of Labor, Licensing and Regulation

Interpreting private sector employment patterns is complicated by a lack of comparability in employment data by sub-sector from one year to the next due to "non-economic " changes in reporting – firms with multiple work sites reporting their employment in a different location from one year to the next, or reporting their activity under a different industry sub-code. Such data coding changes over time for specific firms are not public information. Coding changes in 2004 distorted the comparisons between 2003 and 2004 in a number of sectors within the business and professional services categories, tending to understate 2004 growth rates.

Employment growth within the professional and business services sector was likely positive but limited in 2004, and this sector has not returned to the growth rates of the late 1990's, in spite of the rapid growth in

Employment in Information Sector

	County		*Washington Region*	
Year	*Jobs (000)*	*% Change*	*Jobs (000)*	*% Change*
1996	15.6	-5.5%	96.1	5.70%
1997	15.9	1.9%	100.6	4.7%
1998	17.0	6.9%	105.1	4.5%
1999	17.0	0.0%	113.0	7.5%
2000	18.0	5.9%	128.2	13.5%
2001	16.8	**	133.3	4.0%
2002	15.9	-5.3%	117.6	-11.8%
2003	15.2	-4.7%	111.3	-5.4%
2004	14.8	-2.4%	108.1	-2.9%

Source: Maryland Department of Labor, Licensing and Regulation

***2000 vs. 2001 data not comparable due to changes in Sub-industry coding.*

Employment in Scientific Research and Development Sector

	County		*Washington Region*	
Year	*Jobs (000)*	*% Change*	*Jobs (000)*	*% Change*
1996	6.3	-3.1%	32.0	-2.9%
1997	6.7	6.3%	32.8	2.5%
1998	6.4	-4.5%	35.0	6.7%
1999	6.5	1.6%	37.3	6.6%
2000	7.4	13.8%	39.3	5.4%
2001	10.6	**	41.9	6.6%
2002	11.9	12.6%	43.5	3.8%
2003	12.3	3.0%	44.4	2.1%
2004	12.5	1.8%	44.5	0.2%

Source: Maryland Department of Labor, Licensing and Regulation

***2000 vs. 2001 data not comparable due to change in sub-industry coding.*

federal contracting in the County discussed below. Reported data by subsectors are distorted by data coding changes. Within subsectors, employment continued to expand in research and development firms, by 1.8% in 2004. This sector includes firms conducting research in a wide variety of areas, and including biotechnology and related health areas. This sector is expanding more rapidly in the County than in the rest of the Washington region.

The County continues to lose jobs in the information sector (the telecommunications services sector) as consolidation occurs nationwide and in the region. The County's declines in this sector are less severe than in the Washington region. Other business service sectors in the County exhibiting job growth included financial services firms, with job gains in financial securities firms, commercial banking, and credit intermediation firms. Legal Services employment has increased 25% since 2000. Architectural and Engineering Services firms added to employment in 2004, reflecting the rapid growth in residential construction and renovation activity.

Goal: Support continued growth in professional and business services.

Federal Contracting A+

Federal contracting is a major part of the professional services base of the County, and recent growth in contracting activity in the County is a major success story. Federal contracting awards to County firms increased 34% in FY2004, and federal contracts are now almost 75% higher than in FY2001. Federal contracting has grown dramatically since 9-11, with expenditures focused on data processing, telecom, and professional services meeting defense and homeland security needs. County firms have been very successful in this market, increasing their share of procurement in the Washington area since 2001, after a period from FY1998 to FY2001 when contracting activity in the County was relatively flat.

Federal Contract Awards (in $000)

Year	*County*		*Washington Region*	
	Total	*% Growth*	*Total*	*% Growth*
FY93	$2,730,703	-1.1%	$16,139,579	1.7%
FY94	$2,751,439	0.8%	$17,876,310	10.8%
FY95	$3,328,579	21.0%	$19,375,499	8.4%
FY96	$3,195,492	-4.0%	$21,059,930	8.7%
FY97	$3,244,770	1.5%	$22,004,032	4.5%
FY98	$3,554,097	9.5%	$24,410,269	10.9%
FY99	$3,444,326	-3.1%	$26,238,228	7.5%
FY00	$3,787,672	10.0%	$29,231,792	11.4%
FY01	$3,514,633	-7.2%	$31,400,000	7.4%
FY02	$4,728,146	34.5%	$36,100,000	15.0%
FY03	$4,867,000	2.9%	$42,200,000	16.9%
FY04	$6,600,000	34.4%	$50,013,000	18.4%

Source: GSA Federal Procurement Data Center
Data tabulations by George Mason University and MNCPPC, Research and Technology Center

Federal contracting continues to evolve into more complex contracts focusing on solving very challenging problems in date processing, information technology, telecommunications, and management of complex and often large scale public sector responsibilities. The Federal Government's need to process very large data sets on a very short time basis, and to make information available to multiple parties while still maintaining security, presents very challenging issues. Federal contracting activities are increasingly dominated by larger firms with a successful track record with interested agencies, often with contractors located in close proximity and having constant contact with agencies. These activities provide continuing opportunities for County firms that have both expertise and a long-standing reputation of excellence in working with many agencies.

The key role of federal contracts to the region, including Suburban Maryland, is described in comprehensive annual reports by Stephen Fuller, Director of the Center for Regional Analysis at George Mason University. The Washington region now receives one of every six dollars nationwide in federal contracts, having experienced extraordinary growth over the last two decades that has accelerated since 9-11. The Department of Defense now accounts for 51% of total contract activity in the Washington region in FY04, an increase of 38.7% from just one year earlier. Defense accounted for 90% of all the growth in FY04. Health and Human Services, Treasury, Justice, Transportation, and National Aeronautics and Space Administration were the other largest federal agencies (along with the General Services Administration which makes lease payments on behalf of these and other agencies). Suburban Maryland firms enjoyed a 36% growth in defense contracts and a 12.0% increase in non-defense contracts in 2004. (Stephen Fuller, "Federal Procurement Spending in the Washington Area Increases by $7.8 Billion in 2004, up 18.4%, to a Total of $50,000 Billion", June 30, 2005).

Goal: Promote growth in federal procurement in the County equal to that in the Washington region.

The Retail Sector B+

Retail activity increased significantly in 2004, with retail sales tax collections increasing by 6.7%. The County continues to experience lesser gains than statewide (State of Maryland increase was 9.1% in 2004). Retail sales growth continues in the first half of 2005. While retail sales are growing, consolidation in the retail sector continues to occur as larger retailers take a bigger share of the market. Retailers are reducing employment even with significant sales gains due to rising worker productivity. Employment in retail trade declined at a 2.6% rate in 2004, and is now 5.4% below its peak in 2000. This trend is likely to continue for the foreseeable future, with little prospect for a return to growing employment in retail services activity.

Retail Sales Tax Collections

Year	*Total*	*% Growth County*	*State*
CY94	$293.1	7.7%	7.4%
CY95	$300.0	2.4%	3.6%
CY96	$311.7	3.9%	3.0%
CY97	$305.1	-2.1%	5.3%
CY98	$316.4	3.7%	3.9%
CY99	$335.8	6.1%	8.1%
CY2000	$358.0	6.6%	8.2%
CY2001	$371.6	3.8%	3.0%
CY2002	$375.2	0.9%	1.6%
CY2003	$390.1	4.0%	3.5%
CY2004	$416.2	6.7%	9.1%
CY2005	-	5.6%	6.7%

Source: Montgomery Department of Finance
*Note: * Data for CY2005 are through April*

Growth in Retail Employment County and State 1996-2004

Year	*County*	*State*
1996	0.2%	0.6%
1997	3.3%	1.3%
1998	1.4%	-0.6%
1999	2.1%	1.5%
2000	2.1%	1.0%
2001	-1.1%	-1.4%
2002	0%	-0.4%
2003	-1.8%	0.2%
2004	-2.6%	0.2%

Source: Maryland Department of Labor, Licensing and Regulation

Goal: Growth in retail sales comparable with the State, reflecting the County's high income level and economic growth targets equal to the State.

THE BUSINESS ENVIRONMENT

Business Attraction and Retention A

The County continues to pursue a proactive strategy for recruiting and retaining businesses. The recently adopted Strategic Plan for Economic Development for Montgomery County provides the foundation for the County's strategies moving forward. The plan includes a target employment growth rate averaging two percent annually, along with strategies for targeted County investment and outreach to promote business growth and retention in key sectors, and also endorses continued investment in education and transportation infrastructure.

The County experienced relatively little job loss from closings or relocations over the last year, and continued to attract new employers to the County; most notably in the biotech, IT and international business sector. The County's reputation as an international center for biotech was reinforced by some highly publicized attractions in early 2005, including Canon U.S Life Sciences, Acambis Pharmaceuticals, and Xceleron. All three companies are projected to triple their current employment levels over the next five years, for a total of over 250 new biotech jobs in the County. Acambis and Xceleron, British-based companies, chose Montgomery County to open their new North American finish/fill manufacturing facility and new North American headquarters, respectively. In the IT sector, the County attracted Intelsat General Corporation and retained international satellite leader World Space. In addition, Proxy Aviation, a brand new aerospace company with numerous military contracts, chose Montgomery County as its base of operations.

Top County Successes in 2004

Company	*Existing Jobs*	*Forecasted Expansion 1-5 Years*
Medimmune	1000	250
Human Genome Research	1000	400
The Institute for Genomic Research	500	250
Meso Scale	200	300
SRA International	270	100
First Federal	40	100
Kirkegaard & Perry Laboratories	48	15
Rexahn	19	40
S*Bio	0	50
Proxy Aviation	0	45
College of American Nurse Midwives	0	32
Fidelis Security	9	20
Glycomimetics	15	10
Optinuity	0	17

Source: Montgomery Department of Economic Development

The year 2004 was marked by the completion of a number of major investments in the County's infrastructure and the pursuit of other important business and community promotion strategies. The completions of the Bethesda North Conference Center and the Strathmore Center for Performing Arts are state-of-the-art facilities that will provide long term benefits to the County. The Strathmore Center, with an extensive schedule of performances from the Baltimore Symphony as well as many other well known musicians and performers, makes Montgomery County the center for the arts for suburban Maryland.

The County's long term investment strategy of promoting biotechnology and information technology through an incubator program continues to yield great benefits. The County's second business incubator, the Silver Spring Innovation Center, opened already over 90% percent leased, and has since filled even more. One of the tenants, Radius Technology, was named the Maryland Incubator Technology Company of the Year, and many other companies already have products on the market. The County's first incubator, the Maryland Technology Development Center (MTDC) in Rockville, continues to be filled to capacity with waiting lists and is the regions most successful incubator. Since its opening in 2000, 30 companies have now graduated from the MTDC and all 30 relocated in the County. Today, the graduate companies employ over 1,100 people and lease 330,000 square feet of office and lab space in the County.

Major Losses to the County in 2004
(Jobs and/or Companies Lost)

Company	*Jobs Lost*	*Reason Lost*
K-B Toys	10	1
Fiserv	75	2
Human Genome Sciences	192	2
Penn Parking Incorporated	26	1
Team Creative Services	219	1
Kitchen, Etc.	25	1
Alexus Int'l. Inc.	10	2
Hughes Network Systems	60	2
Manugistics	90	2
Loral Skynet	15	2
Axcelis Technologies	22	1

1. Plant Closure
2. Mass Layoff - No Recall
Source: Montgomery Department of Economic Development

The County is currently in the planning and design stage for three more business incubators: one as part of the new East County Center for Science and Technology adjacent to the new U.S. Food and Drug Administration (FDA) consolidated campus in White Oak; one as part of the Montgomery College Germantown Campus Center for Science and Technology; and an incubator program for service-oriented small businesses in Wheaton.

County Budget for Economic Development Marketing

Year	*$*
FY98	$329,152
FY99	$608,120
FY00	$937,600
FY01	$835,433
FY02	$762,621
FY03	$676,190
FY04	$653,000
FY05	$636,700
FY06	$636,700

Source: Montgomery County Department of Economic Development

Other County investments have also contributed to a supportive business climate in the County. The brand new Montgomery County Conference Center opened in November 2004. This public/private partnership between the County, the State, Quadrangle Development and Marriott, which manages the Conference Center and attached 225 room hotel, has been an overwhelming success. Bookings came much faster than the normal industry standard for a new facility, and after only eight months in operation, the Conference Center brought the County just over $1 million in revenue. Original forecasts had the facility running at a small deficit for the first two years, but the demand has proven to be much greater than originally projected. Based on the stipulations of the ownership agreement between the County and the State, 100 percent of all net operating profits from the Conference Center go to the County.

County Budget for Economic Development Fund (EDF)

Year	*Economic Development Grant & Loan Program*
FY 96	$1,000,000
FY 97	$1,023,450
FY 98	$1,048,540
FY 99	$1,968,400
FY 00	$1,251,780
FY 01	$5,221,430
FY 02	$2,221,430
FY03	$480,150
FY04	$465,750
FY05	$566,580
FY06	$552,080

Source: Montgomery County Department of Economic Development

The efforts to revitalize downtown Silver Spring continue to be a tremendous success as retail and office space continues to fill up. New retail, including Borders Books has opened along with new movie theaters, and a new hotel in downtown Silver Spring is going up and should be completed in 2006. Work on the new Rockville Town Center is also well underway and its targeted opening is still on schedule for 2006.

The County significantly reduced its budget for economic development marketing, and the budget remains far below pre-recession levels in spite of rapid growth in tax revenues. Increasing the marketing budget to its prior level would be a wise investment in the County's future economy. The County's Economic Development Fund, which provides grants and loans to attract and retain new businesses, is an important tool for the County's economic development efforts. It remains funded at levels comparable with recent years, approximately $1 million. As in the past, there is flexibility to go beyond that amount if special opportunities arise. This includes a recapitalization of the County's Small Business and Revolving Loan Fund.

The County will also benefit from the ongoing progress being made by the FDA as it builds out its new White Oak Campus. Three buildings have already opened and over 1,500 employees are now on site. In total, the FDA will spend approximately $1 billion through 2010 and bring a targeted 8,500 employees to the campus, an increase of 3,000 employees from the 5,000 now working for the FDA in the County.

<u>Goal</u>: Promote business development strategies in the County's Strategic Plan for Economic Development that encourage private sector development and private/public sector partnerships.

County Tax Structure B-

Previous studies demonstrate that the County's tax structure as measured by the combination of all types of taxes is competitive with surrounding jurisdictions. The County's quality of life, reflecting in part the quality of public services supported by County tax revenues, is paramount in location decisions of firms and households alike. With the improving revenue picture in the County, the County should consider reductions in the income tax rate, which was raised to provide revenues needed during the economic slowdown. With the highest marginal income tax rate in the State and region, the role of the income tax in the County's overall business climate must be carefully considered. Pressure to reduce property tax rates will continue to be intense, given the very large increases in property tax assessments.

With property tax revenues projected to increase at above average rates for the next three years, the option of reducing the income tax rate to pre-recession levels must not be forgotten. This issue should be addressed when county fiscal circumstances stabilize in the next year or two as the economic recovery accelerates and once the State's budget crisis is resolved.

Goal: Continue to assure that the County has a competitive tax structure.

CONSTRUCTION ACTIVITY AND DEVELOPMENT CAPACITY

Non-Residential Construction B

Office Vacancy Rates 1997 - June 2004 (Percent)

	All Office	*Class A*	*Class B*	*Class C*
*1997**	7.1	5.8	6.6	*
*1998**	7.0	6.2	5.8	*
*1999**	5.3	4.6	3.8	*
*2000**	5.9	5.0	5.1	*
*2001 -1st **	5.8	5.1	4.3	*
*2001-2nd**	6.5	6.3	5.3	*
*2001-3rd**	7.2	7.2	6.0	*
2001-4th	7.5	9.5	6.0	5.9
2002-1st	7.9	9.4	6.8	6.3
2002-2nd	8.5	10.5	7.2	5.6
2002-3rd	8.8	10.6	7.8	5.5
2002-4th	9.1	10.6	8.2	6.9
2203-1st	8.9	9.9	8.4	6.6
2003-2nd	9.1	9.8	8.5	8.5
2003-3rd	9.3	10.2	8.7	7.8
2003-4th	9.3	10.5	8.6	7.0
2004-1st	9.6	10.6	9.0	7.3
2004-2nd	9.5	10.1	9.2	7.4
2004-3rd	9.1	9.5	9.1	6.7
2004-4th	8.9	9.5	8.4	7.9
2005-1st	8.6	8.5	9.1	7.6
2005-2nd	8.1	7.7	8.6	7.3
Office Space Inventory 2004 (million in square feet)				
Total Space	60.7	26.6	26.0	6.1
Vacant Space	5.7	2.9	2.4	0.4

** Earlier reports. Comparability with current data is affected by changes in how properties are classified*

Source: Realty Information Group - CoStar

The market for commercial construction in the County has changed considerably over the last half dozen years, evolving from a period of rapid building in 1999-2002 to one with a reduction in the demand for new space, rising vacancy rates, and a virtual cessation of new construction commitments in the 2003-2004 time period. The County experienced a very orderly transition from a high demand market in the late 1990's to the present. According to data from Co-Star, vacancy rates for office space increased from 7.5% at the end of 2001 to 9.5% in the second quarter of 2004. Vacancy rates were considerably higher in Northern Virginia, which had greater expansion in building in the late 1990's and a sharper decline in telecommunication and related activity in the early part of the recession than in Montgomery County.

With the slowdown in demand and higher vacancy rates, it became much easier to find attractive space in most geographic markets. Space was very plentiful in the northern part of the County, such as Germantown, in 2003 and 2004. However, commercial rents in the County declined only slightly from their peak levels, with rents in Class A space declining about five percent from their peak in early 2003 through mid-2004. Rents in Class B and C markets remained virtually flat.

With the virtual cessation of new starts after 2002, commercial completions in the 2003-2005 time period have been much lower. Approximately 2.9 million square feet of commercial space (office, retail, and industrial) was completed in 2004, almost twenty percent below the average of the last four years, 1999-2002. Only 1.2 million square feet of office space was completed in 2004. Completions in 2004 are far below levels consistent with long term job growth targets of approximately 9,000 jobs annually. Completions of commercial space have averaged almost 3.5 million square feet annually over the last five years, 1999-2003, the goal articulated in the proposed Strategic Plan for Economic Development presented to the County Council by the County Executive.

While completions are presently low, the market for commercial space has significantly improved over the last eighteen months and vacancy rates are now declining. Vacancy rates for Class A space have declined from their peak in the first quarter of 2004 of 10.9% to 7.7% in the second quarter of 2005. The number of prospective tenants shopping for space has increased in the last year, though tenants are still in a position to bargain hard. Closing lease deals remains difficult and often involves lengthy negotiation. Costs of tenant improvements remains very high, with build-out costs for quality facilities often $40-45 per square foot.

Notwithstanding the improved tone in the leasing market, very few new projects are being started at present, implying completions will remain low for 2005 and 2006. While job growth has been sufficient to absorb some vacant space, a resumption of building will require more robust job growth than at present.

As an indication of the immediate prospects for new commercial projects, some land owners have petitioned for zoning changes from commercial to mixed use in order to take advantage of high rates of return in providing multi-family housing. While these decisions reflect immediate business opportunities, the supply of buildable commercial land in the County is limited, and buildable land removed from the inventory of buildable commercial sites will make commercial building that much more expensive later on.

Commercial Completions 1985-2004
(000 SF)

Year	*Total*	*Office*	*Retail*	*Industrial*	*Other*
1985	6,058	4,079	782	752	445
1986	7,014	4,733	1,050	799	392
1987	5,078	2,905	932	596	645
1988	4,005	1,607	937	1,305	160
1989	4,405	2,581	619	1,158	46
1990	2,491	1,173	576	509	232
1991	3,048	950	1,017	933	149
1992	1,129	576	309	103	130
1993	2,738	1,716	766	90	167
1994	706	206	280	56	164
1995	1,373	236	780	285	71
1996	1,237	80	766	219	172
1997	2,135	400	1,064	241	429
1998	2,592	432	915	651	593
1999	3,699	1,404	559	610	1,126
2000	3,033	1,708	510	534	282
2001	4,592	2,627	704	718	544
2002	3,857	2,134	601	864	258
2003	3,280	1,852	397	306	724
2004	2,895	1,233	585	187	890

Source: Maryland National Capital Park and Planning Commission

Looking to the future, the market for buildable land is likely to be increasingly important to the future path of commercial development. The supply of buildable commercial space in the County is limited. Even in a period with very few building commitments being made, there is virtually no buildable land for sale at a price that would make building profitable. Land prices for buildable commercial space will likely increase significantly when space demands increase and the incentives to build increase. To illustrate, over the last seven to eight years, the price of buildable land in the northern part of the County has increased about eight percent annually. Buildable land in Germantown is now approximately $35/square foot (of completed office space), part of the total price of finished space of approximately $170/square foot (inclusive of tenant buildout costs of $45/square foot).

Buildable land in the southern part of the county is more expensive, particularly in the downtown Bethesda area. A shortage of land and rising demands for new space could significantly increase land prices and the ultimate price of office space when the commercial market again expands.

Goal: Maintain non-residential completions in office, retail, and industrial categories above 3.5 million square feet annually over the long run to support current employment growth targets.

Residential Development A-

The expansion in residential housing in the County that began in 1999 slowed to 4,200 units in 2004, somewhat below the annual average of 5,000 units completed in the 2002-2004 period. The pace of zoning approvals remains at a high level, with sites accommodating 7,400 units approved in 2004, and an annual average of 6,000 units over the four year period 2001-2004.

Montgomery County Housing Sales Prices (Median price, $000)

Year	*New SF Detached*		*Existing SF Detached*		*New SF Attached*		*Existing SF Attached*		*All Single Family*	
	$	*% Change*	$	*% Change*	$	*% Change*	$	*% Change*	$	*% Change*
1989	$287.0	24.3%	$200.0	15.6%	$145.5	22.2%	$118.0	15.7%	$145.0	
1990	$318.9	10.8%	$207.0	3.5%	$158.3	8.9%	$126.0	6.8%	$166.5	14.8%
1991	$309.0	-2.8%	$208.0	0.5%	$146.0	-7.8%	$128.0	1.6%	$170.0	2.1%
1992	$319.8	0.3%	$217.0	4.3%	$185.7	27.2%	$128.5	0.4%	$172.9	1.7%
1993	$343.8	3.2%	$217.0	0.0%	$180.9	-2.6%	$130.0	1.2%	$182.5	5.6%
1994	$312.5	-0.1%	$220.0	1.4%	$180.3	-0.3%	$131.0	0.8%	$187.0	2.5%
1995	$343.8	7.6%	$220.7	0.3%	$199.6	10.7%	$130.0	-0.8%	$190.0	1.6%
1996	$312.5	-9.1%	$225.0	1.9%	$169.9	-14.9%	$132.0	1.5%	$189.5	-0.3%
1997	$343.3	9.9%	$230.0	2.2%	$174.0	2.4%	$134.9	2.2%	$187.0	-1.3%
1998	$361.7	5.4%	$235.0	2.2%	$218.6	25.6%	$137.0	1.6%	$197.0	5.3%
1999	$364.2	0.7%	$243.0	3.4%	$212.2	-2.9%	$139.0	1.5%	$205.0	4.1%
2000	$390.6	7.3%	$262.9	8.2%	$262.4	23.6%	$142.7	2.7%	$217.5	6.1%
2001	$436.5	11.7%	$289.0	9.9%	$265.9	1.1%	$155.8	9.0%	$236.1	8.5%
2002	$481.3	10.3%	$340.0	17.6%	$278.0	4.7%	$185.5	19.0%	$282.9	19.8%
2003	$590.8	22.7%	$385.0	13.2%	$364.2	31.0%	$229.0	23.4%	$324.9	14.8%
2004	$666.5	12.8%	$450.0	16.9%	$423.5	16.3%	$279.0	21.8%	$384.9	18.5%

Source: Montgomery County Planning Department, Research and Technology Center.
Compiled from data provided by the State Department of Assessments and Taxation, 5/01

Residential permits declined to 3,800 units in 2004, with most of the decline in the multifamily market, suggesting completions may be slowed in 2005. Permit activity in the first six months has again increased to levels of recent years.

The pace of housing expansion is very important to the future job growth in the County, and to housing availability and the rate of housing price inflation. The importance of achieving the target level of housing completions can hardly be overstated, for the County is experiencing a very rapid increase in demand for housing. The combination of economic prosperity, excellent public services, and an unmatched quality of life as reflected in both environmental, cultural, and recreational opportunities will drive demand for the foreseeable future. It is noteworthy that housing price increases have been rapid even as job growth has remained relatively modest. A continuation of current residential building trends is critical to the County's long term economic future.

Demand for housing in the County continues to increase, reflecting low mortgage rates and the desirability of living in the County. Single family housing prices increased 23.2% in 2004, the third year of very large increases (a 67% increase over the prior three years, 2001-2004). The median sale prices for new units ($666,000 for new detached units and $423,000 for new attached units) are far above prices for existing units. With limits on development and high land prices, new development is increasingly dominated by expensive homes. The median price for new attached units has increased fifty percent in just two years.

Plan Approvals, Permits and Completions (Dwelling Units)

Year	*Approvals*	*Permits*	*Completions*
1985	5,824	9,642	9,766
1986	3,323	12,026	10,366
1987	5,100	7,352	9,820
1988	4,177	6,533	8,397
1989	8,351	5,813	6,137
1990	5,392	4,198	3,270
1991	5,766	3,092	4,704
1992	1,843	3,564	2,944
1993	3,139	3,453	3,083
1994	2,393	3,962	2,854
1995	4,842	4,372	2,937
1996	5,052	3,721	3,114
1997	1,777	2,938	3,855
1998	2,891	4,401	3,200
1999	4,428	4,959	5,464
2000	2,527	4,113	4,178
2001	5,719	5,757	4,174
2002	4,750	4,936	5,484
2003	6,239	4,428	5,461
2004	7,419	3,821	4,274

Source: MNCPPC

Rapid increases in housing prices will substantially increase the County's property tax base (see section below), as well as increase the wealth of existing homeowners and landowners. Rising prices also are dramatically worsening the affordable housing problem in the County, so that many persons who work in the County cannot afford to live in the County. The gap between incomes and housing prices is expanding for many county workers, and posing a difficult challenge to firms seeking to recruit new employees. Even with lower mortgage rates than several years earlier, the cost of living in the County is increasingly out of reach of many who work, or would like to work, in the County. Housing prices are also rising rapidly in many surrounding jurisdictions, forcing workers with below average incomes to make even longer commutes.

The County's programs in Affordable Housing provided an average of 210 units annually over the last five years. Without a significant increase in the amount of housing being built in the County, the gap between incomes and housing prices for many County workers will continue to expand.

Apartment Vacancy Rate 1990 - 2004 Montgomery County, Non- Subsidized Units

Year	*Vacancy Rate*	*Vacant Units*
1990	5.2%	2,759
1991	6.5%	3,581
1992	6.1%	3,430
1993	5.3%	2,970
1994	4.3%	2,480
1995	N.A.	N.A.
1996	4.7%	2,742
1997	4.4%	2,565
1998	3.9%	2,297
1999	3.0%	1,759
2000	2.4%	1,461
2001	1.8%	1,022
2002	3.7%	2,127
2003	3.8%	2,604
2004	5.5%	3,193

Source: Maryland National Capital Park & Planning

County policies are critical to continued expansion of the housing stock. Recently initiated reviews of County zoning and permitting procedures, compliance, and project inspections -- including moratoriums on selected building activities -- as a result of concerns about projects in Clarksburg present major new uncertainties to residents, businesses, and developers. A timely completion of these reviews and the formulation of clear and transparent procedures that are administered with minimal delay and uncertainty are critical to continued expansion of the housing stock in the County.

Zoning policies also have important effects, but with very long time lags. MNCPPC zoning policies are oriented toward an expansion of the multifamily housing stock and a long term shift of the housing stock toward a higher fraction of units in multifamily rather than single family. In the five year period 1999-2003, MNCPPC approved almost 24,000 units, 29% of which were single family housing, with

the remainder in multi-family (52%) and townhouse units (19%). Over that same time period, approximately 24,000 units were completed, 61% in single family units, indicating that current market forces favor single family construction from the entire inventory of existing site approvals that might be developed. The effect of current zoning policies will affect the mix of housing being constructed over a long time horizon, as well as the relative prices of different types of units.
The growing housing affordability problem reflects a combination of high incomes of County residents and the very desirable quality of life, together with the limitations on growth in the housing stock. The present housing goal of 4,500 units is below the level that will support targeted job growth. Consideration of housing growth objectives is likely to be the subject of debate in the near future.

Goal: Pursue zoning and permitting policies that result n housing completions of 4,500 units annually, to support population and job growth targets.

PUBLIC SERVICES AND PUBLIC SECTOR CAPACITY

Income Tax Receipts A

The County is now enjoying very rapid increases in income taxes, reflecting both the nine percent increase in income tax rates in 2004 and an improving economy. The State is also enjoying a huge surge in income tax revenues, and it is likely that income tax revenue in the County will be higher than predicted in both FY05 and FY06. The County can expect significantly higher revenue distributions from the State in the months ahead. The reasons for the current revenue surge, which has proven a surprise at the both the federal and state levels, are not yet understood, but have their origins in higher realizations of capital gains and higher estimated and final payments for small businesses, stock bonuses, and other income not subject to withholding.

Income Tax Revenue
($ Millions)

Year	*County Total ($Millions)*	*County % Growth (One Year)*	*State % Growth (One Year)*
FY95	446.2	1.3%	3.0%
FY96	480.8	3.1%	2.5%
FY97	544.3	13.2%	10.3%
FY98	602.8	10.8%	3.4%
FY99	689.2	14.3%	3.4%
FY00	761.1	10.4%	10.5%
FY01	812.4	6.7%	8.2%
FY02	867.0	6.7%	-7.1%
FY03	788.0	-9.1%	-1.4%
FY04	869.7	10.4%	8.0%
FY05 est	924.0	6.3%	6.7%**
FY06 est	948.7	2.7%*	6.3%**

Source: Montgomery Department of Finance ,OMB Schedule F2 in County Executive's Recommended FY06 Budget
County data are income tax collections disbursed to County, which lag State collections by a few months.
** County estimate in FY05 Budget approved, May 2004*
***State estimate, Bureau of Revenue Estimates, March 2004.*
Current State data indicate Income tax growth for FY05 recedes 10 percent.

Goal: Maintain growth in income tax receipts consistent with income growth in the County.

Property Tax Base A

The County's property tax base is now expanding rapidly, reflecting rapid increases in housing prices. Most of the recent increase in the property tax base is attributable to residential assessments, since additions to the commercial tax base are now growing more slowly as completion levels slow down.

County Property Tax Base
Residential and Non-Residential Share

Year	Residential		Non-Residential	
	Real	Real	Personal	Total
FY86	69.5%	17.8%	12.7%	30.5%
FY91	66.3%	21.0%	12.7%	33.7%
FY92	67.1%	20.5%	12.4%	32.9%
FY93	68.5%	19.6%	11.9%	31.5%
FY94	69.7%	18.7%	11.7%	30.4%
FY95	71.0%	17.4%	11.6%	29.0%
FY96	71.2%	16.9%	11.9%	28.8%
FY97	70.9%	16.6%	12.5%	29.1%
FY98	71.5%	16.7%	11.8%	28.5%
FY99*	71.4%	16.7%	11.9%	28.6%
FY00	71.1%	17.0%	11.9%	28.9%
FY01(OLD)**	70.5%	17.4%	12.1%	29.5%
FY02(OLD)**	69.6%	18.0%	12.4%	30.4%
FY01(NEW)***	75.9%	18.7%	5.4%	24.1%
FY02(NEW)***	75.4%	19.4%	5.2%	24.6%
FY03(NEW)***	75.7%	19.4%	4.9%	24.3%
FY04(NEW)***	75.6%	19.1%	4.3%	23.4%

SOURCE: Montgomery Department of Finance
NOTES: Data include Takoma Park Annexed Portion.
* Numerous changes in tax law have reduced personal property taxable base effective FY98.
** Shares are based on 40% full-assessment value for residential and non-residential real property.
*** Shares are based on 100% full-assessment value for residential and non-residential real property.

Increases in housing prices reflect the extraordinary demand for property in the County and the capitalization of the County's economic success in the prices of properties. The Strategic Plan for Economic Development endorsed the strategy of promoting employment growth as a means of furthering growth in the commercial property tax base.

For the next several years, the recent inflation in housing prices is being reflected in much higher residential reassessments, in which much higher residential reassessments, much higher residential reassessments, occur on a three-year cycle.

Because of the magnitude of housing price appreciation and the three year reassessment cycle, very large increases in the tax base are assured for many more years. The real property tax base in the County is predicted to increase 12.9% in FY07, 10.8% in FY08, and 9.8% in FY09. Absent changes in the tax rate or other forms of taxpayer relief, property tax increases will be very large.

Goal: Achieve increases in the property tax base at least proportional to growth in income in the County, and promote increased growth in the commercial property tax base.

Growth in Components of County Tax Base

Year	*Residential Real*	*Non-Residential Real*	*Personal Property*	*Total*
FY94	5.2%	-1.2%	1.6%	3.5%
FY95	3.2%	-5.7%	0.5%	1.2%
FY96	1.7%	-1.6%	4.2%	1.4%
FY97	2.3%	1.1%	7.7%	2.8%
FY98	2.6%	2.0%	-3.6%	1.8%
FY99	2.2%	2.9%	2.8%	2.4%
FY00	2.4%	4.1%	3.2%	2.8%
FY01	2.6%	6.8%	5.1%	3.6%
FY02	3.8%	7.8%	3.0%	4.6%
FY03	6.4%	5.7%	0.6%	5.9%
FY04	8.9%	6.1%	-6.2%	7.6%

Source: Montgomery Department of Finance

*Note: * Growth in FY02 is based on 100% full-assessment value of real property in fiscal years 2001 and 2002*

Public Expenditures vs. Revenue Capacity C

The County's fiscal situation has dramatically improved, reflecting previous increases in income and energy taxes and very rapid increases in assessments that have resulted in the opportunity for sharply rising property tax revenues. The State budget has also improved dramatically, allowing the State to increase transfers to local governments in FY06.

Share of Total Tax Revenue

Year	*Property Tax Share of Total Tax Revenue*	*Income Tax Share of Total Tax Revenue*
FY 94	39.9%	25.3%
FY 95	39.9%	25.0%
FY 96	39.6%	25.0%
FY 97	37.6%	26.3%
FY 98	36.0%	27.1%
FY 99	33.1%	28.7%
FY 00	33.0%	30.3%
FY01	32.4%	31.1%
FY02	31.1%	30.6%
FY03	32.5%	27.5%
FY04	31.5%	27.6%
FY05 (est.)	31.7%	27.1%
FY05 (est.)	32.6%	26.4%

Source: Montgomery Department of Finance
OMB Schedule, F2 in County Executive's Recommended Budget FY06

The County has consistently underestimated revenues from income, recordation, and transfer taxes, which could reflect a cautionary posture after facing unexpected revenue shortfalls three years earlier. The County revenue estimating procedures have been underestimating income tax revenues since FY04, principally because projections of next year's revenues are based on an estimate of the current year's revenues made before the start of the current year. Yet at the time of the projection, the current year is in fact almost completed, and a more accurate revenue estimate for the current year is available. As a result, revenues have proven to be far in excess of estimates, by about $30 million each year, providing an unexpected revenue windfall and budget flexibility to the County. This difference arose in FY04 and is being repeated in subsequent years. Income tax revenues increased 10.4% in FY2004 substantially in excess of estimates (actual revenue of $869.6 million versus an estimated $837.7 million). Because FY05 estimates were based on FY04 estimates that proved to be too low, the County's revenues again exceeded estimates, by approximately $31 million in FY05.

Year	Trends in County Public Expenditures and Tax Revenues				Expenditure vs. Revenue Capacity	
	% Change in Expenditures	*% Change Total Tax Revenue*	*% Change in Income Tax Revenue*	*% Change in Property Tax Revenue*	*Expenditures Million ($)*	*Revenues Million ($)*
FY 94	7.1%	10.8%	15.6%	3.5%	1,702	1,819
FY 95	5.6%	2.7%	1.3%	1.4%	1,798	1,868
FY 96	5.8%	2.9%	3.1%	1.2%	1,902	1,922
FY 97	4.6%	7.8%	13.2%	2.8%	1,940	2,072
FY 98	5.7%	7.4%	10.8%	1.8%	2,101	2,224
FY 99	8.2%	7.9%	14.3%	-0.7%	2,258	2,399
FY 00	4.7%	4.6%	10.4%	4.3%	2,365	2,509
FY 01	7.5%	4.1%	6.7%	2.1%	2,542	2,612
FY02	6.4%	8.4%	6.7%	4.0%	2,705	2,832
FY03	8.2%	1.4%	-9.1%	5.5%	2,926	2,870
FY04	5.5%	12.5%	10.3%	6.6%	3,089	3,149
FY05 Budget	7.1%	6.3%	2.7%	6.1%	3,308	3,328
FY05 Estimated	7.5%	8.8%	6.3%	6.6%	3,321	3,401
FY06 Approved	7.7%	5.9%	6.2%	3.3%	3,561	3,527

Source: Montgomery County Approved Operating Budget, FY06

The County projects a 6.2% increase in income tax revenues in FY06 from its initial estimate of FY05 revenues, but only 2.7% above its current estimate of realized FY05 receipts. The County's income tax revenues for FY06 will undoubtedly be far above revenues predicted, providing another revenue windfall. With revenues rising rapidly, The challenge now for the County is to determine the appropriate level of expenditures and taxes, and the form of tax relief that might be provided. The County has increased spending at a rapid rate from FY03 to the present, with expenditures rising by 7.7% in FY05 and budgeted to increase by 7.7% in FY06. The County maintained spending throughout the economic slowdown, financed by increases in taxes and fees. The structure of the County's budget is evolving. In the period FY98 to FY02, spending increased at a 6.3% annual rate, with the number of county employees increasing approximately two percent per year; for the period FY02 through FY06, spending is increasing at a 7.1% rate and County Government employment (work years) has fallen by three percent over this four year period. One explanation for this shift in the budget is the County's increasing use of contractors to provide public services.

The County can expect increases in the property tax base exceeding ten percent annually for the next several years. Budgeting decisions each year for the immediate future will involve the choice between property tax relief versus higher spending. The FY06 budget stayed within the Charter limit on property tax revenues by enacting a four percent reduction in the tax rate and expanding targeted property tax relief for families with low incomes and net worth. However, the combination of major property tax reductions and spending increases of 7.7% were achieved only by diverting approximately $32 million in the operating budget that were slated to fund capital investments. (The County finances some capital expenditures in the operating budget, so-called PAYGO financing of capital spending, in amounts that have

Montgomery County Expenditures - Operating Budget ($ Millions)							
Category	*FY 01*	*FY04*	*FY05 Approved*	*FY06 Approved*	*% Change FY96 - FY01*	*%Change FY01-FY04*	*%Change FY05-FY06*
General Government	82	94	102.1	111.13	8.8%	16.3%	9.0%
Public Safety	270	345.6	365.3	409.70	32.7%	21.1%	12.2%
Public Works and Transportation	231.4	211.8	272.0	280.74	4.7%	10.4%	3.2%
Public Works and Transportation	58.5	69.8	56.4	57.51	32.3%	-1.4%	2.0%
Transit Services	68.7	83.5	88.7	95.26	-33.8%	21.1%	7.4%
Parking District Services	14.9	18.8	19.7	22.45	-4.4%	27.5%	14.2%
Solid Waste Services	89.2	99.6	107.3	105.52	18.5%	7.3%	-1.6%
Health & Human Services	177.1		205.9	219.60	72.8%	12.7%	6.7%
Culture & Recreation	55.7	56.2	60.0	66.45	24.9%	5.9%	10.8%
Community Development and Housing	52.6	67.9	63.0	69.42	496.2%	13.5%	10.3%
Other	82.2	99.2	142.2	161.70	0.6%	39.8%	13.7%
Subtotal	951.3	1,142.7	1,217.8	1,326.88	28.7%	17.5%	9.0%
Debt Service	159.2	194.2	203.8	217.07	25.8%	24.7%	6.5%
Montgomery County Public Schools	1,220.7	1,499.00	1,609.40	1,713.74	39.0%	23.0%	6.5%
Montgomery College	128.5	156.4	177.8	196.69	34.7%	33.0%	10.6%
M-NCPPC	82.8	90.3	99.3	107.60	24.5%	11.4%	8.4%
Total - All Agencies	2,542.5	3,082.0	3,308.2	3,561.99	33.3%	21.2%	7.7%

Source: Montgomery County Approved Operating and CIP Budgets, FY05

ranged from $5 million to $60 million in recent years. PAYGO funding was kept low in FY06 to allow more operating cost expenditures.)

The County's decisions on property tax relief are to be applauded, both as to the amount of relief and the nature of tax changes enacted. There are strong arguments in support of, on the one hand, general property tax rate reductions (a continuation of constant tax rates is recommended absent new circumstances justifying more complex changes in the overall rate structure), or, alternatively, the use of selected property tax relief measures that are targeted to low income home owners (an equity argument that selected low income groups deserve special relief). The County's program of property tax relief approved for FY06 is a balanced approach to property tax relief that is responsive to both points of view about tax incidence.

The broader issue of the level of public expenditures and the decision to shift monies capital budgets to the operating budget in FY06 is more complex. County expenditures have been increasing at a faster rate than the increase in personal income of County residents. The magnitude of the recent income tax increase, rising property tax reassessments, and rapid expenditure growth will support a concern by many that expenditure growth is too rapid.

Given the rapid growth in tax revenues and the growing infrastructure needs of the County, particularly in transportation, there are strong arguments for shifting more of the County's resources from growth of operating budgets into capital budgets. Consideration of expenditure levels and tax relief will continue to attract much public attention in the future.

Funding of Major Capital Investment Budget (CIP) Proposals
FY 99 - 05

		FY 99-04 **Amended** (Millions of $)	FY 01-06 **Amended** (Millions of $)	FY 03-08 **Amended** (Millions of $)	FY 05-10 **Approved** (Millions of $)	Percent Change FY 01-06 to **FY 05-10**
MCPS	Total	567.2	697.8	637.1	912.8	0.3
	State	229.5	295.2	173.6	138.2	-0.5
	County	337.7	402.6	463.5	774.6	0.9
Mont. Coll	Total	53.7	120.6	114.9	230.7	0.9
	State	11.7	46.0	42.6	67.2	0.5
	County	42.0	74.6	72.3	163.5	1.2
MNCPPC	Total	102.6	132.6	117.8	140.3	0.1
	State	25.0	26.4	19.8	18.4	-0.3
	County	77.6	106.2	98.0	121.9	0.1
Transportation	Total	373.6	408.4	433.4	519.1	0.3
	State	62.0	34.7	20.4	10.8	0.7
	County	311.6	373.7	413.0	508.3	0.4
All Programs	Total	1097.1	1359.4	1303.2	1802.9	0.3
	State	328.2	402.3	256.4	234.6	-0.4
	County	768.9	957.1	1046.8	1568.3	0.6

The County's capital budget in recent years has been adversely affected by major reductions in capital funds from the State. In the four years covered by the FY01-06 budget to the current FY05-10 budget, State aid to the County for proposed capital spending in four major categories (schools, transportation, Montgomery College, and MNCPPC) has declined from $402 million to only $234 million, a 42% decline. The County has increased its own expenditures by 64%, resulting in total proposed spending increasing 33% during this period. State aid for schools was decreased 53% and for transportation by 69%. The County's budgeted increase of $590 million is being offset by $168 million less in State funds. With improvements in the State budget, and an election year coming, state aid to local governments will likely increase in FY07 and beyond. The County should increase its capital spending, even as State aid is increased. In addition, every effort should be made to actually spend capital funds that have been appropriated. Actual spending often falls well below appropriated spending; spending deferred is foregoing more immediate benefits to County citizens.

Montgomery County Capital Improvements Budget (CIP) - ($ Millions)

County Government	*FY01-FY06 Amended*	*FY03-FY08* Amended*	*FY05-FY10 Amended*	*Percent Change*
General Government	366,665	222,023	114,902	68.7%
Public Safety	78,773	101,762	186,655	137.0%
Transportation	408,403	433,416	529,024	29.5%
Health and Human Services	874	0	2,596	197.0%
Libraries and Recreation	72,712	87,008	132,561	82.2%
Conservation of Natural Resources	44,687	64,816	54,185	21.2%
Housing and Community Development	7,831	8,822	5,081	35.1%
Other				
Subtotal: County Government	979,945	917,847	1,025,004	4.6%
Other Agencies				
MCPS	697,771	637,106	933,515	33.8%
Montgomery College	120,579	114,946	235,610	95.4%

Goal: Public expenditure growth should reflect long term revenue capacity implied by growth in personal income with stable tax rates, and County budgets should significantly increase the share of County public spending that is devoted to capital expenditures.

Transportation Capital Expenditures D

Improving the County's transportation system is the single biggest challenge in improving the quality of life in the County and the environment for continued and sustained economic growth. Lost time for families, increased environmental costs of added pollution, the costs to businesses of lost worker productivity and increased recruiting costs, and the limitations on households and firms in making location decisions are imposing a huge cost to the County. Traffic congestion and limits on mobility are the largest single factor reducing the quality of life in the County.

Large numbers of workers commute into and out of the County daily. According to the 2000 Census, 188,000 County residents commute outside the County to their place of work, while County firms employ 154,000 workers who reside in different jurisdictions. Unless the County wishes to expand its resident population significantly, County firms will continue to have to rely on attracting workers who reside in other jurisdictions.

The County's transportation problem is traceable to failure to build planned infrastructure over many years while population and job growth occurred. Increased travel demand is accounted for largely by increases in non-work trips, as increasing incomes and living choices have increased car ownership and the number and length of trips. Vehicle usage continues to increase. The County can not 'solve' its congestion problems by halting job growth.

The County Council took an important step in approving the *Go Montgomery!* transportation policy, and in supporting the InterCounty Connector, and the County has taken some important steps to advance the quality of transportation services in the County. The ICC will have the single largest impact on congestion in the County of any transportation investment strategy that has been considered. The route for the ICC has now been approved by the State, and review of final plans and environmental impacts is now underway. County Executive Doug Duncan has continued to support the ICC at every stage, and the Governor is committed to starting construction on the ICC in 2006.

The County's financial commitment to transportation remains woefully inadequate, especially at a time when tax revenues are growing rapidly. Transportation has received the smallest budget increments of any major sector within the County's budget over a very long period of time. Within the County's overall transportation activities, The County has been much more successful in devoting significant amounts of resources to public transportation, but has been much less successful in its efforts to increase capacity and service to highway users. The County also should receive very good marks for its investments in safety and the significant improvements in pedestrian and bicycle pathways. However, improvements in the highway system have been very limited, held back by inadequate funding, projects delays, and administrative issues that have reduced the rate of spending of appropriated funds.

In the County's approved operating budget for FY06, transportation received the smallest increase of any major category of the budget, repeating a pattern that has been evident for many years. Within the transportation budget, highways received the smallest increase, much below increases for transit services and parking services. Mass transit funding increased 7.4% in FY06, versus a two percent increase for the Department of Public Works General Fund that principally funds highways projects. FY06 is the second year of the County's two-year Capital Improvement Budget (CIP) and few projects are added in the second year of the CIP absent special emergency needs. Transportation received two very small projects in the second year. Transportation funding in the CIP over many years has been very modest. In addition, the reported CIP six year budgets have often included relatively little transportation spending in Years 1 and 2 of the budget, the funding which is relatively certain to be spent. (Projects appearing in Years 3 and beyond in the CIP are often delayed and not ultimately pursued.)

Spending on highway projects has been very limited in the last few years, both because of low appropriations and other factors that have resulted in less monies being spent than appropriated, with the gap between appropriations and actual spending in FY05 the largest in many years. FY06 promises more successes in highway projects. The Montrose Parkway project entirely funded by the County is expected to begin construction in early FY06. New construction projects on Briggs Chaney Road and Valley Park Drive in Damascus are now underway. While these major projects will make a contribution, the great majority of new lane miles of highway built in Montgomery County (12-20 miles annually on average) are local and secondary roads within subdivisions rather than arterial or larger roadways.

The County has invested more significantly more in transit. Twenty five million riders use the Ride-On each year. In order to promote its use and to promote service connections to Metro, the County maintains the fare at $1.25, well below fares that often approach $2/ride in other major cities. The County will spend about $85 million on Ride-On bus service in FY06, with approximately one fourth provided by State, a subsidy of approximately $3.40 per rider. In FY06 Metro will receive $105 million for service in Montgomery County, to provide service to 150,000 individual transit trips daily on average (a subsidy of $1.92/trip). (For the entire Washington Metropolitan Area Transit Authority, $610 million is provided as public assistance, serving an estimated 348 million individual trips, at a cost of $1.75 per trip.)

<u>Goal</u>: Enact policies to implement the *Go Montgomery!* transportation policy, including accelerating planning and the initiation of projects, enacting policies that provide long term financing to complete long term objectives, and aggressively promoting development of the InterCounty Connector.

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